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## Letter Ruling 88-10: Taxation of Beneficiary of Qualified Subchapter S Trust on Dividends From S Corporation

May 27, 1988

The ("Trust") was established on December 30, 1982, and you represent that it is a "qualified subchapter S trust" under Internal Revenue Code ("Code") § 1361(d)(3). You state that the election to be treated as a qualified subchapter S trust was made pursuant to Code § 1361(d)(2) on December 30, 1982. You also state that, but for the election under Code § 1361(d)(2), the Trust would not be considered a trust within the meaning of Code §§ 671-678.

### Issues

Are dividends distributed from an S corporation to a shareholder which is a qualified subchapter S trust taxable to the trust or to the beneficiary? What would the result be if the S corporation distributed the funds directly to the beneficiary and ignored the Trust?

### Discussion

A qualified subchapter S trust has one current income beneficiary, distributes any corpus during the life of the beneficiary to the income beneficiary, terminates the income interest upon the earlier of the death of the beneficiary or the termination of the trust, and upon termination of the trust, distributes all of the assets to the income beneficiary. Code § 1361(d)(3). The beneficiary of a qualified subchapter S trust can elect to have the special provisions of Code § 1361(d) apply to the trust. Code § 1361(d)(2).

If such election is made, then under Code § 1361(d)(1)(A) a qualified subchapter S trust shall be treated as a trust described in Code § 1361(c)(2)(A)(i), which defines one type of trust which can be a shareholder in an S corporation. The type of trust described in Code § 1361(c)(2)(A)(i) is a trust subject to the provisions of subpart E of part I of subchapter J, that is, Code §§ 671-679. Under Code § 1361(d)(1)(B), the election also means the beneficiary of the qualified subchapter S trust is treated as the owner of the portion of the trust consisting of S corporation stock for the purposes of Code § 678(a), which defines when a person other than a grantor is treated as owner of a trust. In summary, for federal income tax purposes, the beneficiary of a qualified subchapter S trust can elect to be treated as the owner of the portion of the trust consisting of stock in a S corporation and to have the trust treated as a trust qualified to be a shareholder in an S corporation.

The general rule under Massachusetts law is that the trustee is required to file a fiduciary income tax return and pay the tax assessed on the taxable income of the trust. G.L. c. 62, § 10(a); G.L. c. 62C, § 6(b). Income received by a beneficiary on which the tax has already been paid by the trustee is not taxable to the beneficiary. G.L. c. 62, § 2(a)(2)(C). However, if a grantor or another person is treated as the owner of any portion of a trust by reason of the provisions of Code §§ 671 to 678, inclusive, the items of income, deduction and credit against tax which are attributable to that portion of the trust are taken into account in computing the taxable income of the grantor or such other person. (Emphasis added.) G.L. c. 62, § 10(e). Such items of income, deduction or credit are not used in computing the taxable income of the trust. Id. At Code § 678(e) there is a cross-reference to the

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provisions in Code § 1361(d) as authority for treating the beneficiary of a qualified subchapter S trust as owner of the part of the trust consisting of S corporation stock.

Conclusions

We conclude that the beneficiary of a qualified subchapter S trust is treated as the owner of that portion of the trust consisting of S corporation stock by reason of the provisions of Code § 678 and that items of income, deduction, and credit which are attributable to the S corporation stock are taxed to the beneficiary. The trustee must file an information return indicating the items of income deduction and credit attributable to the S corporation stock and the name and taxpayer identification number of the beneficiary. G.L. c. 62, § 10(f). We further conclude that a distribution directly to the beneficiary rather than the Trust does not affect the legal relationships and the tax consequences thereof.

Very truly yours,  
Stephen W. Kidder  
Commissioner of Revenue  
May 27, 1988  
LR 88-10